

UNITED STATES BANKRUPTCY COURT  
WESTERN DISTRICT OF NORTH CAROLINA  
CHARLOTTE DIVISION

In Re:	)	Case No. 95-30447
	)	Chapter 13
HOWARD E. SANDERS, SR.	)	
	)	
Debtor.	)	

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**MEMORANDUM OPINION**

This matter came before the Court upon Motion of the Debtor for Turnover, file-dated July 12, 1995. By this Motion, the Debtor seeks turnover of monies distributed from his pension plan which are currently being held in escrow on behalf of his estranged spouse, Maybelline S. Sanders. This matter was heard on August 15, 1995. After a review of the record, the evidence presented, and in light of arguments of counsel, the Court hereby enters the following findings of fact and conclusions of law.

**FINDINGS OF FACT**

Howard Sanders ("Howard Sanders or "Debtor") was employed by the City of Charlotte as a policeman from April 19, 1973 until his retirement on December 1, 1988. As a municipal employee, Howard Sanders was a participant in the Local Government Employees' Retirement System, a defined benefit plan established under N.C. Gen. Stat. § 128, Article 3 (the "pensions plan").

On December 1, 1988, Howard Sanders became disabled and was forced into early retirement. As of that date, he had accrued earned service under his pension plan of 14.5 years and projected (unearned) service of 15.5 years, as calculated under N.C. Gen. Stat. § 128-27. The unearned service award relates to lost future

employment occasioned by Howard Sanders' disability. As of November 30, 1988, Howard Sanders had a balance of \$20,156.98, representing his contributions and interests from April 11, 1973 through November 30, 1988.

Under his pension Plan, Howard Sanders will receive a monthly benefit for the rest of his life. He currently receives \$1,395.50 per month under the pension plan.

Howard Sanders and his spouse Maybelline S. Sanders ("Maybelline Sanders" or "Respondent") separated and a divorce action was commenced in the State District Court for Mecklenburg County, North Carolina prior to his bankruptcy. That action included a request for equitable distribution of the parties' property.

This proceeding was interrupted on April 3, 1995, when Howard Sanders filed a Chapter 13 case with this Court. The Bankruptcy filing has stayed further proceedings in that forum to this point.

Prior to this bankruptcy, on September 26, 1994, the State Court had entered an order directing Howard Sanders to pay Maybelline Sanders 40% of the "pension and/or disability payments" he was currently receiving under his pension plan pending a trial of the equitable distribution matter. This Order was entered pursuant to N.C. Gen. Stat. § 50-20(i), and was without prejudice to either party to contest at trial the proper classification, valuation or distribution of this property.

When Howard Sanders' bankruptcy was filed, he and Maybelline Sanders agreed that the monies payable to Maybelline Sanders under

the State Court Order would be escrowed pending a determination of the nature of those payments. Under that arrangement since April 24, 1995, Maybelline Sanders' domestic counsel has been receiving and holding in escrow payments of \$528.22 per month.

Howard Sanders has moved this Court for turnover of those monies and for an order directing the State Treasurer to make no further distributions to Maybelline Sanders. Howard Sanders makes three primary arguments in support of this request.

First, the Debtor argues that to the extent these monies represent disability benefits, they are not marital property under North Carolina law and are not subject to equitable distribution.

Second, he contends that even if all of these funds, are marital property, Maybelline Sanders, as a creditor holding a property settlement claim, is for bankruptcy purposes merely an unsecured creditor. As such, he contends that her equitable distribution claims should be paid only to the extent provided for under his Chapter 13 plan. He further argues that the pension plan monies are necessary to fund his Chapter 13 Plan, which in turn will preserve other marital assets (i.e., the house) and pay joint debts owed by the couple. He therefore seeks application of all of these monies towards his Chapter 13 plan.

Finally, Howard Sanders argues that his former spouse has failed to timely file a proof of claim in this case, the bar date having run on August 1, 1995. He therefore contends that she holds no allowable claim to these monies.

Maybelline Sanders opposes this Motion, arguing that the interim award of \$528.22 per month is necessary for the maintenance and support of her children. She alleges that by virtue of the State Court Order, these monies have been declared (at least pending entry of a final equitable distribution order) to be her property. As such, she argues that allowing Howard Sanders to use these monies to fund this Chapter 13 plan would be tantamount to a conversion of her property.

Respondent also points out that although the separation of the parties occurred in 1992, for two and one-half years prior to the escrow arrangement, Howard Sanders had made no payment whatsoever to her and she had no previous access to this property. Thus, if the Court elects to apply the payments towards the Debtor's plan, she contends that these amounts should be deducted from the sums released to him.

#### DISCUSSION OF APPLICABLE LAW

It is not necessary to address all of the arguments made by counsel in order to decide this matter. Howard Sanders asks this Court to inject itself in the couple's domestic action to upset the State District Judge's interim order and to direct turnover of these monies. For the reasons stated below, the Court elects not to do so.

The State Court Order directing payment of a portion of Howard Sanders' pension monies to his ex-spouse was entered as a part of the equitable distribution proceeding pending between these parties. Interim distributions of marital property are provided

for under N.C. Gen. Stat. § 50-20(i). That statute provides the State Judge with a tool whereby the Judge may make interim asset transfers to a litigant who is not in control of a couple's assets before the equitable distribution case goes to trial. This statute avoids prejudice to the out-of-possession spouse pending a final trial of the equitable distribution issue. Brown v. Brown, 112 N.C. App. 15 (1993). It is in short a way to prevent one spouse from "starving" the other, pending trial. Such orders are without prejudice to either party's contentions at trial as to the proper classification, valuation or distribution of the property affected.

A claim for equitable distribution of marital property is a statutory right granted to spouses under North Carolina law. Perlow v. Perlow, 128 Bankr. 412 (E.D.N.C. 1991). Such rights are "species of common ownership...vesting at the time of the parties' separation. Perlow, 128 Bankr. at 415, citing N.C. Gen. Stat. § 50-20(b).

However, such rights do not create property rights in marital property, nor liens on the assets. Rather, an equitable distribution claim is simply "a right to equitable distribution of that property, whatever a court should determine that property is." Wilson v. Wilson, 73 N.C. App. 96, 325 S.E.2d 668, cert. denied, 314 N.C. 121, 332 S.E.2d 490 (1985).

Because they do not constitute property interests under North Carolina law, equitable distribution rights create only unsecured claims as against the bankruptcy estate of the spouse who has legal title. Perlow, 128 Bankr. at 415. An equitable distribution right,

not being a perfected lien or property right, is cut off by the bankruptcy trustee's hypothetical lien creditor rights under 11 U.S.C. 544.

Thus, at first glance it would appear that the Debtor's Motion is well founded. However, a close reading of the Bankruptcy Code and review of the nature of the assets for which turnover is sought, lead to the contrary conclusion.

Although his motion does not directly state, Howard Sanders is proceeding under 11 U.S.C. 542(a), which provides in relevant part:

...[A]n entity...in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property....

11 U.S.C. 542(a).

For turnover to be appropriate under Section 542(a) , the property sought must be property which is subject to use, sell, or lease under Section 363 or property which the debtor may exempt under Section 522. In short, the assets sought must be property of the estate, or assets which but for the debtor's exemptions would be property of the estate.

The distributions from Howard Sanders' pension plan are neither. This pension plan is the Local Government Employees' Retirement System, a defined benefit plan established under N.C. Gen. Stat. § 128, Article 3. Under North Carolina law, interests in government employees pension plans are exempt from creditors' claims and are unassignable by the employee. N.C. Gen. Stat. § 128-31.

Given this restriction, such interests do not become property of the bankruptcy estate. This is illustrated by the treatment of ERISA Plans in bankruptcy, under the line of decisions following the Supreme Court's decisions in Patterson v. Shumate, 504 U.S. 753, 112 S.Ct. 2242, 119 L.Ed.2d 519 (1992) and Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365, 110 S.Ct. 680, 107 L.Ed.2d 782 (1990).

Normally, Section 541 of the Code pulls into the bankruptcy estate almost any interest in property that a debtor may possess at the filing date. In like fashion, Section 1306 draws in property acquired after the petition but while the Chapter 13 case is ongoing which would be Section 541 property but for its postpetition nature.

Section 541(c)(2) of the Bankruptcy Code, however, excludes from the bankruptcy estate, property which is subject to a restriction on transfer enforceable under "applicable nonbankruptcy law." 11 U.S.C. § 541(c)(2). ERISA plans must specify that benefits provided thereunder may not be assigned or alienated. 29 USC 1056(d)(1).

In Patterson and Guidry, the Supreme Court concluded that the antialienation provisions in ERISA plans are transfer restrictions within the ambit of Section 541(c)(2). Therefore, interests in ERISA plans never become property of the bankruptcy estate. Patterson v. Shumate, 112 S.Ct. at 2250; Guidry v. Sheet Metal Workers Nat'l Pension Fund, 110 S.Ct. at 687.

More recently, in a nonbankruptcy case, the Fourth Circuit Court of Appeals has held that where an employee covered by an ERISA-qualified Plan has retired and is currently entitled to receive monthly distributions from that plan, these payments are not subject to garnishment. U.S. v. Smith, 47 F.3d 681 (4th Cir. 1995).

The Local Government Employees' Retirement System plan, while established under a state statute, not ERISA, serves the same purpose as ERISA--to safeguard a stream of retirement benefits. More importantly, it, like ERISA, also contains an antialienation provision:

...[T]he right of a person to a pension, an annuity, or a retirement allowance, to the return of contributions, the pension, annuity or retirement allowance itself, any optional benefit or any other right accrued or accruing to any person under the provisions of this Article, and the moneys in the various funds created by this Article, are exempt from levy and sale, garnishment, attachment, or any other process whatsoever, and shall be unassignable except as in this Article specifically otherwise provided. (emphasis added).

N.C. Gen. Stat. § 128-31.

Under the Patterson/Guidry rationale, these distributions are not estate property. With respect to the Debtor's Chapter 13 Plan, these pension benefits are like social security or unemployment compensation benefits--absent other restrictions, a debtor may use them to fund his plan, but they are not subject to garnishment for this purpose. As they are not estate property, they are not subject to turnover under Section 549.



Pension benefits and other deferred compensation rights are, however, potentially marital property under state law and must be classified and valued. And if found to be marital property these benefits are subject to equitable distribution under state law. N.C. Gen. Stat. § 50-20(b)(1).

Therefore, although unsecured as against this estate, Madelline Sanders' equitable distribution claims may be recoverable, when that issue is finally decided, out of these monies. [Here, it is not certain to what extent that these distributions represent retirement benefits (marital property) and to what extent disability benefits (separate property).]

This question is more properly resolved in the state courts. Where pending litigation involves issues of state law, particularly domestic relations law, the Court should favor allowing those matters to be resolved in state court. Caswell v. Lang, 757 F.2d 608 (4th Cir. 1984); In re Claughton, 140 BR. 861 (Bankr.W.D.N.C. 1992), affirmed, 33 F.3d 4 (4th Cir.1995); Perlow, 128 B.R. at 416. For although the Bankruptcy Court usually has jurisdiction, the State Court possesses greater expertise in the identification and distribution of marital property and in other domestic matters. Claughton, 140 B.R. at 868.

Consistent with the longstanding practice in this District, the Court will grant relief from stay to permit the parties to conclude their equitable distribution proceedings in the State Court. The Court will retain jurisdiction over this matter and will review any orders emanating from that action which might

impact property of the estate and the rights and claims of creditors, and will adjust any such order as necessary to make it comply with the Bankruptcy laws. However, with respect to the male Debtor's pension plan benefits, this Court will abstain from interfering with the State Court's interim order as these monies are not estate property and are not reachable by creditors. If Howard Sanders is to receive relief from the earlier interim distribution order, it must come from that Court.

IT IS THEREFORE ORDERED AS FOLLOWS:

1. The Debtor's Motion to Compel Turnover is DENIED.
2. Relief from Stay under 11 U.S.C. 362(d) is hereby granted to permit the equitable distribution litigation to proceed in state Court.
3. This Court will retain jurisdiction over this matter and will review any orders emanating from that action which might impact property of the estate and the rights and claims of creditors, and will adjust any such order as necessary to make it comply with the Bankruptcy laws.

This the \_\_\_\_ day of August, 1995.

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U.S. Bankruptcy Judge